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C O N F I D E N T I A L SECTION 01 OF 02 HARARE 002006

SIPDIS

AF/S FOR BNEULING
NSC FOR SENIOR AFRICA DIRECTOR C. COURVELLE, D. TEITELBAUM
TREASURY FOR OREN WYCHE-SHAW, PASS USTR FOR FLORIZELLE
LISER, STATE PASS USAID FOR MARJORIE COPSON

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TAGS: ECON ETRD PGOV ZI EINV
SUBJECT: WITHOUT DEVALUATION, IMF SEES NO RECOVERY

REF: HARARE 1966

Classified By: Ambassador Christopher Dell for reason 1.5 d

¶1. (SBU) Summary and Recommendation: An International Monetary Fund (IMF) technical mission has analyzed the GOZ's 2005 budget projections and preliminarily concluded that Zimbabwe will suffer a 10.5 percent budget deficit and inflation at over 200 percent next year. RBZ Governor Gono claimed to be "shocked" by this analysis and undertook to win President Mugabe's backing for tighter spending controls to bring the budget deficit down to 3 percent. The Fund staff will report its findings to the Fund's Executive Directors prior to the latter,s late January decision on Zimbabwe's compulsory withdrawal. We recommend Washington press at that meeting for Zimbabwe's expulsion with formal censure as a fall back option. End Summary and Recommendation.

IMF Findings

¶2. (SBU) The 4-member IMF technical team was led by African Department Assistant Director Sharmini Coorey and included Sonia Munoz, Paul Heytens and Sankett Mohaprata. The team briefed the Ambassador on Dec. 9 and told us that having examined the Government's books in detail they are forecasting inflation at 200-220 percent for 2005, the 2005 budget deficit at a staggering 10.5 percent, and GDP growth at minus 1.6 percent. The team's projections contrast sharply with the GOZ expectations of 30-50 percent inflation, 3.5-5 percent growth and a budget shortfall at 5 percent of GDP.

¶3. (SBU) Coorey said that even granting the GOZ every favorable assumption built into its budget, the lowest 2005 inflation figure the team came up with was 168 percent. She added that unique circumstances in 2004 - artificially high demand for money and an appreciating exchange rate (Z$6500:US$ on Jan 1 versus Z$5600-6200:US$ today)) aided the GOZ in driving down year-on-year inflation from 623 to 209 percent in 2004. These conditions would no longer exist in 2005. Coorey expected 2005 inflation to correlate more closely with monetary velocity, belatedly reflecting this year's estimated 350 percent reserve money growth.

¶4. (SBU) Coorey said she was most disturbed about the projected budget shortfall of 10-10.5 percent of GDP. While the economy has shrunk over 30 percent since 1997, the public sector has grown. For several years, the GOZ financed the deficit through private pension funds, requiring fund managers to invest in government paper carrying negative real rates. The GOZ has now largely depleted these resources. (N.B., we frequently encounter retirees who once supported a middle-class lifestyle from their annuity but now receive less than US$100/month.) Coorey said Reserve Bank Governor Gideon Gono admitted current spending plans represent an "election budget," implying the GOZ would not enforce fiscal discipline prior to March's parliamentary elections. The budget calls for a 270 percent raise for GOZ civil servants, clearly designed to ensure ZANU-PF holds onto its voters in the March elections.

¶5. (SBU) The IMF team said that based on its research, the GOZ seems almost certain to devalue its currency in 2005, a view we share (reftel). Through currency depreciation, the GOZ could reduce public spending in real terms and phase out loans to exporters that carry heavily-negative real rates. Because Zimbabwe's private sector is operating far below its productive capacity, especially in mining, the IMF team believes the economy could revert to moderately positive growth after a significant devaluation. The GOZ faces a tradeoff between inflation/devaluation on one hand and output/growth on the other.

Gono,s Reaction

¶6. (SBU) At a chance meeting on December 10, Coorey briefed the Ambassador on her discussion with RBZ Governor Gono, the

evening of December 9. She said Gono had professed to be shocked at the IMF team,s findings and had promised action, especially with respect to the budget deficit. Gono said he would get President Mugabe to sign a letter to the IMF to that effect before Coorey left Zimbabwe. Coorey said she was carrying a copy of the letter with her back to Washington. Subsequently acting Minister of Finance Herbert Murerwa told the Ambassador that the GOZ believes the IMF had used some bad information in its analysis and later altered its conclusions. Murerwa also said the government would bring the deficit down to 7.5 percent.

Comment and Action Recommendation

¶7. (SBU) Comment: The IMF team's report provides solid justification for Zimbabwe's compulsory withdrawal from the Fund and we recommend Washington pursue this option at the January IMF Executive Directors' meeting. If it is not possible to build a majority in favor of compulsory withdrawal, we recommend pursuing a formal Motion of Censure against Zimbabwe. According to the IMF staff, action on compulsory withdrawal by the Fund's Board of Governors could not take place before the September annual meeting in any case. Besides expressing real disapproval of Zimbabwe's economic performance, a vote in favor of either compulsory withdrawal or censure in January will be an important signal to Zimbabwe's embattled electorate in the run up to the March parliamentary elections. A vote to defer a decision for an additional six months will be conversely spun in the official media as both a victory for Mugabe against Zimbabwe's enemies and approval for the GOZ's economic policies. As to President Mugabe,s letter promising action, talk is cheap, especially in an election year.
DELL